Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

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| In the Matter of | ) | |
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| Section 272(b)(1)'s "Operate Independently" | ) | WC Docket No. 03-228 |
| Requirement for Section 272 Affiliates | ) | |

REPLY COMMENTS OF QWEST


James T. Hannon
Andrew D. Crain
Suite 950
607 14th Street, N.W.
Washington, DC 20005
(303) 672-2926

Attorneys for

QWEST SERVICES CORPORATION


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Qwest Services Corporation ("QSC") on behalf of its subsidiaries, Qwest LD Corp. ("QLD"), Qwest Communications Corporation ("QCC"), and Qwest Corporation ("QC") (collectively referred to as "Qwest") respectfully submits this reply to comments filed in the above-captioned rulemaking proceeding addressing the Section 272(b)(1) requirement that Bell Operating Company ("BOC") separate affiliates (*i.e.*, providing in-region interLATA services) "operate independently" from the BOC.[1] As shown below and in Qwest's opening comments, neither the prohibition on sharing operating, installation and maintenance ("OI&M") functions nor the prohibition on joint ownership of switching and transmission facilities between BOCs and their Section 272 affiliates is necessary to prevent cost misallocation and discrimination. Elimination of the OI&M and joint ownership prohibitions would enhance competition in the market for interLATA services by allowing BOCs and their affiliates to operate more efficiently and by improving customer service.

[1] *See In the Matter of Section 272(b)(1)'s "Operate Independently" Requirement for Section 272 Affiliates*, WC Docket No. 03-228, Notice of Proposed Rulemaking, FCC 03-272, rel. Nov. 4, 2003 ("*Notice*"); *see also* 68 Fed. Reg. 65665, rel. Nov. 21, 2003, Public Notice, DA 03-3742, rel. Nov. 21, 2003.

## I. INTRODUCTION AND SUMMARY

In its *Notice*, the Federal Communications Commission ("Commission" or "FCC") specifically asked whether its rules prohibiting sharing OI&M functions and joint ownership of switching and transmission facilities (and the land and buildings where they are located) should be eliminated.[2] As expected, those companies burdened by the existing prohibitions -- the BOCs -- answered with a resounding yes while those companies gaining a competitive advantage from the rules -- the large interexchange carriers ("IXCs") -- argued that the rules must be preserved.

Qwest and the other BOCs (*i.e.*, Verizon, SBC and BellSouth) strongly advocated that the OI&M and joint cost rules be eliminated[3] -- claiming that these prohibitions were not necessary in 1996 when the Commission first adopted them in the *Non-Accounting Safeguards Order*[4] and are not necessary today.[5] Moreover, these "structural separation" requirements force BOCs and their Section 272 affiliates to forgo efficiencies and impose unnecessary costs on these affiliates' customers.[6] Qwest and other BOCs argued that after almost seven years experience it should be apparent that the costs to BOCs and their customers far outweigh any potential benefits from the continued imposition of these unnecessary rules.[7] Furthermore, Qwest and the other BOCs

[2] *See* 47 C.F.R. § 53.203(a).

[3] Comments of SBC Communications Inc. at 2-5 ("SBC"); BellSouth Corporation at 7-14; Verizon at 5-6. *See also* Comments of the United States Telecom Association at 3-6 ("USTA"). Comments were filed Dec. 10, 2003.

[4] *See In the Matter of Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, as amended*, First Report and Order and Further Notice of Proposed Rulemaking, 11 FCC Rcd 21905 (1996) ("*Non-Accounting Safeguards Order*"), *on recon.*, 12 FCC Rcd 2297 (1997), *on further recon.*, 12 FCC Rcd 8653 (1997), *aff'd sub nom. Bell Atlantic Tel. Cos. v. FCC*, 131 F.3d 1044 (D.C. Cir. 1997), *Third Order on Recon.,* 14 FCC Rcd 16299 (1999) ("*Third Order on Reconsideration*").

[5] Qwest Comments at 1-5.

[6] Qwest Comments at 11-13; SBC at 2-3; BellSouth at 7-8; Verizon at 2, 5-6.

[7] Qwest Comments at 11-13; SBC at 2-3; BellSouth at 7-8; Verizon at 2, 5-6.

demonstrated that the joint ownership and OI&M restrictions contained in Section 53.203(a) of the Commission's rules[8] provide little, if any, additional protection against cost misallocation and discrimination.[9]

Not surprisingly, AT&T, Sprint and MCI, the beneficiaries of the existing rules, argue that the OI&M and joint ownership prohibitions are required by Section 272(b)(1) and nothing has changed since their adoption in 1996 that would justify eliminating or modifying these rules.[10] They claim that without the OI&M and joint ownership prohibitions BOCs inevitably will misallocate costs and discriminate against other interLATA competitors. AT&T goes so far as to assert that the prohibitions on sharing OI&M and joint ownership are "the best regulatory tools" to prevent cost misallocation and discrimination.[11] AT&T also claims that eliminating the OI&M and joint ownership restrictions would turn BOC Section 272 affiliates into "mere shell corporations."[12]

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[8] 47 C.F.R. § 53.203(a).

[9] While the Commission's prohibitions on OI&M and joint ownership are based on the "operate independently" requirement of Section 272(b)(1), the Commission's stated purpose in adopting these rules was to prevent BOCs from discriminating in favor of their Section 272 affiliates and improperly allocating costs between BOCs and their affiliates (*i.e.*, cross-subsidization). Changes in the Commission's price cap rules have all but eliminated any possibility of cross-subsidization at the federal level while the nondiscrimination requirements contained in Sections 272(c), 272(e) and other Sections of the Act provide more than adequate protection against unreasonable discrimination and ensure that BOCs will not be able to favor their section 272 affiliates at the expense of other customers and competitors.

[10] AT&T Corp. at 31 ("AT&T"); WorldCom, Inc. d/b/a MCI at 1-3 ("MCI"); Sprint Corporation at 2-3 ("Sprint").

[11] AT&T at 3.

[12] *Id.* at 2. This claim is absurd with regard to QCC, Qwest's section 272 affiliate. QCC operates a nationwide network serving large numbers of customers outside QC's (*i.e.*, the BOC's) 14-state region. In fact, QCC was required to divest itself of its in-region business as a condition of its merger with U S WEST, Inc.. Thus, while removal of the OI&M and joint ownership restrictions would allow QCC to operate more efficiently and provide better service to in-region customers, it is ludicrous to assert -- as AT&T has -- that QCC will become a "mere shell corporation" if the Commission eliminates these restrictions.

The only thing that the BOCs and the large IXCs appear to agree on is that the Commission's purpose in adopting the OI&M and joint ownership prohibitions was to guard against the possibility of cost misallocation and discrimination. That said -- the question raised by this proceeding is whether these restraints are needed now. While the Commission asks for comment on the benefits and costs of these restraints, Qwest believes that these restraints should not be retained unless the Commission finds that there is a compelling public need.

The outcome of this proceeding should not be determined by whether the BOCs adequately demonstrate that the costs of these rules outweigh any benefits -- which they clearly do[13] -- but whether continued imposition of the rules is required by both the public interest and the interests of competition. Qwest does not question that the current rules serve the interests of individual competitors such as AT&T, MCI and Sprint. Qwest also readily admits that elimination of the OI&M and joint ownership rules would serve its own interests. However, the concern of the Commission under the 1996 Act should be in furthering the interests of competition, not in protecting any individual competitor or class of competitors.

The Act has an overt bias -- it favors competition over regulation. In fact, in numerous instances the Act directs the Commission to evaluate its existing rules in light of competition and eliminate any rule that is no longer necessary.[14] Thus, if a market is competitive, there should be few rules and any such rules should apply equally to all competitors. In this new competitive world there is no justification for creating redundant rules to guard against highly speculative potential harms. That is exactly what the large IXCs are requesting when they argue that the

[13] The Commission's OI&M and joint ownership rules are not needed to protect consumers or competition. Nor are they needed to ensure that rates and practices are just and reasonable and not unreasonably discriminatory. The costs imposed on BOCs, their Section 272 affiliates and their customers by these rules are "real" costs which far outweigh any hypothetical benefits that are associated with the continued existence of these rules.

[14] *See* 47 U.S.C. § 161. *See also,* 47 U.S.C. §§ 157 nt, 160.

existing OI&M and joint ownership restraints must be maintained to guard against cost misallocation and discrimination. These "evils" are nothing new -- they have been around since the dawn of public utility regulation -- and the Commission has an arsenal full of regulatory weapons to detect such violations and punish violators.[15] It does not need the OI&M and joint ownership rules.

Section 272, itself, contains explicit requirements that provide more than adequate protection against possible cost misallocation and discrimination.[16] Contrary to the implications of AT&T and others,[17] Congress did not direct the Commission to adopt the OI&M and joint ownership rules; it simply required that a BOC and its interLATA affiliate "operate independently." The Commission was neither compelled to adopt the existing prohibitions on OI&M and joint ownership nor is it required to maintain them in their present form. The Commission permitted BOCs and their Section 272 affiliates to share administrative and other services. In doing so, the Commission has repeatedly found that Section 272 does not require total structural separation and that the economic benefits to consumers outweighed any potential harm to competition.[18] In this rulemaking, the Commission should come to a similar conclusion with respect to its OI&M and joint ownership rules.

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[15] Neither the OI&M rules nor the joint ownership rules are necessary to prevent cost misallocation or unreasonable discrimination by BOCs. The Commission's Part 32 rules already prohibit cost misallocation and cross-subsidization and Sections 272(c) and (e) prohibit BOC discrimination in favor of its Section 272 affiliate.

[16] 47 U.S.C. §§ 272(c); 272(e)

[17] AT&T at 2-4, 10-15; Sprint at 4; MCI at 3.

[18] *Non-Accounting Safeguards* Order, 11 FCC Rcd at 21986 ¶ 168. *See also*, *Third Order on Reconsideration,* 14 FCC Rcd at 16313 ¶ 18.

II. THERE IS NO LEGAL BASIS FOR AT&T'S CLAIM THAT THE COMMISSION MAY NOT MODIFY OR ELIMINATE ITS OI&M AND JOINT OWNERSHIP RULES

AT&T asserts that the Commission may not modify or eliminate its OI&M and joint ownership rules because the Commission determined [in rejecting Verizon's forbearance petition][19] that it did not have the authority to forbear from applying its OI&M rules.[20] Simply stated, AT&T's position is that once the Commission adopts rules in implementing a section of the Act where the Commission concedes it does not have the authority to forbear, it may not modify these rules. Under AT&T's view, the Commission "better get it right the first time" since any subsequent modifications of its rules would be the equivalent of forbearance and, therefore, unlawful.

AT&T relies on *ASCENT v. FCC*[21] to provide support for this novel administrative law argument. In doing so, it ignores a long line of cases addressing agency authority in rulemaking proceedings.[22] AT&T's reliance on *ASCENT* is misplaced. Not only were the facts of *ASCENT* quite different but this decision dealt with the Commission's authority to circumvent explicit

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[19] *See In the Matter of Petition of Verizon for Forbearance from the Prohibition of Sharing Operating, Installation, and Maintenance Functions Under Section 53.203(a)(2) of the Commission's Rules*, CC Docket No. 96-149, Memorandum Opinion and Order, FCC 03-271, rel. Nov. 4, 2003, *appeal pending sub nom. The Verizon Telephone Companies v. FCC*, No. 03-1404 (pet. for rev. filed Nov. 10, 2003). *See also*, *DIRECTV v. FCC,* 110 F.3d 816 (D.C. Cir. 1997).

[20] AT&T at 29-30.

[21] *Id.* at 30, citing to *ASCENT v. FCC*, 235 F.3d 662, 667 (D.C. Cir. 2001).

[22] *See Chevron v. Natural Resources Defense Counsel,* 467 U.S. 837 (1984); *Motor Vehicle Manufacturers' Assn. v. State Farm*, 463 U.S. 29 (1983); *Committee for Effective Cellular Rules v. FCC*, 53 F.3d 1309 (D.C. Cir. 1995); *Rainbow Broadcasting v. FCC*, 949 F.2d 405 (D.C. Cir. 1991); *Florida Cellular Mobil Communications Corp. v. FCC*, 28 F.3d 191 (D.C. Cir. 1994), *cert. denied,* 514 U.S. 1016 (1995); *DIRECTV v. FCC,* 110 F.3d 816 (D.C. Cir. 1997); *Harrington v. Chao.* 280 F. 3d 50 (1st Cir. 2003).

statutory requirements in Section 251(c) -- not with Commission rules promulgated in implementing this section of the Act.

AT&T's position regarding the Commission's authority (or lack thereof) to modify or eliminate its OI&M and joint ownership rules cannot withstand judicial scrutiny. It is settled law that the Commission has broad authority to change its rules as long as it provides a reasoned explanation.[23] The fact that any such rule change may "upset the expectations" of industry participants such as the large IXCs in no way limits the authority of the FCC.[24] Thus, contrary to the claims of AT&T,[25] the Commission has sufficient authority to modify or eliminate its OI&M and joint ownership rules as long as it provides a "reasoned explanation" for any such change.

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[23] In *Committee for Effective Cellular Rules*, the court held that the FCC's authority to change its rules is sustained "as long as it provides a reasoned explanation for doing so." 53 F.3d at 1317. *Citing Florida Cellular Mobil Communications Corp. v. FCC*, 28 F.3d at 196-97. The Court went on to state "[T]his flexibility is necessary to allow agencies, particularly the FCC, to respond to rapidly changing 'technological, commercial, and societal aspects of the … industry' as they fulfill their delegated duties." Citing *Rainbow Broadcasting*, 949 F.2d at 409.

In *Florida Cellular Mobil Communications Corp. v. FCC*, the Court stated "[I]f an agency is to function effectively, however, it must have some opportunity to amend its rules and regulations in light of its experience. As this court has recently stated, 'the fact that an agency rule represents a change in course simply requires courts to make sure that prior policies are being deliberately changed, not casually ignored, and that the agency has articulated permissible reasons for that change.'" 28 F.3d at 196, citing *Clinton Memorial Hosp. v. Shalala*, 10 F.3d 854, 859 (D.C. Cir. 1993).

[24] "A rule that upsets expectations, as we held in *Bell Atlantic Telephone Cos. v. FCC*, 79 F.3d 1195, 1207 (D.C. Cir. 1996), may be sustained 'if it is reasonable,' *i.e.*, if it is not 'arbitrary' or 'capricious.' A change in policy is not arbitrary or capricious merely because it alters the current state of affairs. The Commission 'is entitled to reconsider and revise its views as to the public interest and the means needed to protect that interest,' (citing *Black Citizens for A Fair Media v. FCC*, 719 F.2d 407, 411 (D.C. Cir. 1983)), if it gives a reasoned explanation for the revision." *DIRECTV v. FCC,* 110 F.3d at 826.

[25] AT&T's argument that the Commission lacks authority to change its rules is surprising in light of its earlier comments in the Verizon forbearance proceeding where it appeared that AT&T acknowledged that the Commission had the authority to eliminate its OI&M rules through a rulemaking proceeding (while arguing that the Commission did not have the authority to forbear). *See* Ex Parte, Letter from David L. Lawson, Sidley Austin Brown & Wood LLP, to Marlene H. Dortch, Secretary, FCC, dated July 9, 2003, *Re: Verizon Petition for Forbearance*

## III. SECTION 272's REQUIREMENT THAT BOCs AND THEIR AFFILIATES "OPERATE INDEPENDENTLY" CAN BE SATISFIED WITHOUT THE OI&M AND JOINT OWNERSHIP PROHIBITIONS

AT&T asserts that it is impossible to satisfy Section 272(b)(1)'s requirement that BOC interLATA affiliates "operate independently" from the BOC without the OI&M and joint ownership rules.[26] AT&T argues that removing these rules would make BOC affiliates "dependent" on BOCs.[27] The Commission should reject this argument for what it is -- nonsense.

Independent companies of all shapes and sizes outsource everything from administrative functions (*e.g.*, HR, payroll, tax preparation, housekeeping, etc.) to core functions such as manufacturing and data processing. No one would claim that DELL is not "operating independently" simply because it chooses to purchase virtually all the components of its computers rather than manufacture them itself. Even in the absence of the OI&M and joint ownership rules, QCC, Qwest's Section 272 affiliate, will be operating independently both in-region and out-of-region. The fact that -- with the elimination of the OI&M and joint ownership rules -- QCC would have the opportunity to improve its customer service and operate in a more efficient manner in no way compromises its "independence." Under such a scenario, QCC

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*from the Prohibition of Sharing Operating, Installation and Maintenance Functions Under Section 53.203(a)(2) of the Commission's Rules*, CC Docket No. 96-149 at 8.

[26] AT&T at 3, 10-14.

[27] AT&T looks to the American Heritage Dictionary 3rd Ed. (which defines "independent" as "[f]ree from the influence, guidance, or control of another or others; self-reliant") to support its claim that BOC affiliates would be "dependent" if the OI&M and joint ownership rules were eliminated. *See* AT&T at 12. AT&T's perverse logic basically leads to the conclusion that a company is "dependent" if it does not satisfy the literal definition of the term "independent" as defined in the American Heritage Dictionary.

would be no more "dependent" on QC (the BOC) than most other companies operating in today's economy are on their respective suppliers.[28]

Congress did not include the OI&M and joint ownership restrictions when it prescribed the "operate independently" and other requirements in Section 272(b). These restrictions are the product of the Commission's Non-structural Safeguards Rulemaking. Congress may or may not have intended for the Commission to adopt additional rules to implement the "operate independently" requirement -- it is not clear. What is clear -- given the ambiguity of the statute -- is that the Commission had the authority to adopt the OI&M and joint ownership restrictions in 1996 and has the authority to modify or eliminate them in this rulemaking proceeding.

## IV. THE OI&M AND JOINT OWNERSHIP RULES ARE NOT NEEDED TO GUARD AGAINST COST MISALLOCATION AND DISCRIMINATION

It is widely recognized that there are many other existing Commission rules that provide more than adequate protection against improper cost allocation (*i.e.*, cross subsidization) and unreasonable discrimination without imposing the same costs on BOCs and their affiliates as the OI&M and joint ownership restrictions. In fact, the Commission has found repeatedly that non-structural safeguards are sufficient to guard against discrimination and cost misallocation.[29] In

[28] There are few, if any, "fully integrated" companies such as the old Bell System (*i.e.*, pre-divestiture AT&T) or the Ford Motor Company (of earlier generations) operating in today's economy. Virtually no modern American company could satisfy AT&T's outdated and overly-narrow definition of "operate independently" nor would it make good business sense to try to do so.

[29] *See, e.g.*, *In the Matters of: Amendment of Sections 64.702 of the Commission's Rules and Regulations (Third Computer Inquiry); and Policy and Rules Concerning Rates for Competitive Common Carrier Services and Facilities Authorizations Thereof; Communications Protocols under Section 64.702 of the Commission's Rules and Regulations*, Report and Order, 104 FCC 2nd 958 (1986); *In the Matter of Furnishing of Customer Premises Equipment by the Bell Operating Telephone Companies and the Independent Telephone Companies*, Report and Order, 2 FCC Rcd 143 (1987); *In the Matter of Policy and Rules Concerning the Interstate, Interexchange Marketplace, Implementation of Section 254(g) of the Communications Act of*

the *LEC Classification Order*, the Commission acknowledged that price cap regulation effectively limits BOCs' ability to increase the price of exchange access service.[30] Since then, the risk that BOCs may impose higher access charges on long distance competitors by improperly allocating costs has been reduced even further with the Commission's adoption of the CALLS plan in 2000.[31]

As Qwest noted in its comments, cost misallocation and cross-subsidization already are prohibited by the Commission's existing Part 32 rules that govern accounting for transactions between the BOCs and their affiliates.[32] These rules are designed to prevent BOCs from using regulated operations to cross-subsidize the long distance operations of their Section 272 affiliates. Thus, contrary to the claims of the large IXCs, BOCs neither have the incentive to engage in cost misallocation nor the ability to escape detection. The OI&M and joint ownership prohibitions provide little additional protection and, in and of themselves, do not prevent cost misallocation.

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*1934, as amended, 1998 Biennial Regulatory Review – Review of Customer Premises Equipment and Enhanced Services Unbundling Rules In the Interexchange, Exchange Access and Local Exchange Markets*, Report and Order, 16 FCC Rcd 7418, 7443-46 ¶¶ 42-46 (2001).

[30] *In the Matter of Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LEC's Local Exchange Area and Policy and Rules Concerning the Interstate, Interexchange Marketplace*, 12 FCC Rcd 15756, 15829-30 ¶ 126 (1997).

[31] The CALLS Plan essentially severed the link between access costs and prices. *See In the Matter of Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers, Low-Volume Long-Distance Users, Federal-State Joint Board On Universal Service,* Sixth Report and Order in CC Docket Nos. 96-262 and 94-1, Report and Order in CC Docket No. 99-249, Eleventh Report and Order in CC Docket No. 96-45, 15 FCC Rcd 12962 (2000), *aff'd in part, rev'd in part, and remanded in part*, *Texas Office of Public Util. Counsel, et al. v. FCC*, 265 F.3d 313 (5th Cir. 2001), *cert. denied sub nom. NASUCA v. FCC*, 535 U.S. 986 (2002).

[32] *See* 47 C.F.R. § 32.27.

Similarly, AT&T and the other large IXCs' exaggerated claims concerning the lack of adequate safeguards against discrimination are without merit.[33] Sections 272(c), (d) and (e) along with Section 251 ensure that BOCs cannot discriminate against IXC competitors while Section 272(b)(5)'s posting requirement ensures that other carriers and regulators have information on all transactions between a BOC and its affiliate.

Section 272(c) prohibits a BOC from discriminating between its Section 272 affiliate and any other entity in the provision or procurement of goods, services, facilities, and information, or in the establishment of standards.[34] The continued application of Section 272(e) will ensure that BOCs cannot use any perceived residual control over local exchange bottlenecks to undermine competition in the long distance marketplace. For example, Section 272(e)(1) will continue to impose an absolute prohibition against a BOC fulfilling requests for local exchange and exchange access service for its affiliate any more quickly than it fulfills such requests for competing providers. Also, enforcement of Section 272(e)(3) will prevent BOCs from engaging in a price squeeze.[35] Section 272(e)(4) prevents BOCs from discriminating with respect to intraLATA facilities or services, or shifting costs with respect to such facilities or services.

Section 251(c)(5) coupled with Section 272(e)(1) will continue to prohibit BOCs from discriminating in the provision of changes/updates in information necessary for the transmission and routing of services using a BOC's facilities or networks.[36] BOCs also will continue to have a duty to interconnect with IXCs on terms and conditions that are just and reasonable.

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[33] AT&T at 10-15; MCI at 3-7; Sprint at Attachment 1 at 13-15.

[34] 47 U.S.C. § 272(c).

[35] This section provides that the BOC "shall charge [its Section 272] affiliate … an amount for access to its telephone exchange service and exchange access that is no less than the amount charged to any unaffiliated interexchange carriers for such service." *See* 47 U.S.C. § 272(e)(3).

[36] *See Non-Accounting Safeguards Order*, 11 FCC Rcd at 22002-03 ¶ 208.

In summary, the Commission has numerous rules and regulations in place that prohibit BOCs from improperly allocating costs and discriminating against IXC competitors. The OI&M and joint ownership prohibitions provide little, if any, additional protection against cost misallocation and discrimination.

## V. CONCLUSION

The existing prohibitions on sharing OI&M and joint ownership (between BOCs and their Section 272 affiliates) give AT&T and other large IXCs a distinct competitive advantage over BOC Section 272 affiliates in the provision of interLATA services. If there ever was a justification for these prohibitions that time has long since passed as Qwest and other BOCs have demonstrated in their comments. As such, Qwest requests that the Commission eliminate Section 53.203 of its rules at the earliest possible date.

Respectfully submitted,

QWEST SERVICES CORPORATION

By: /s/ James T. Hannon

James T. Hannon
Andrew D. Crain
Suite 950
607 14th Street, N.W.
Washington, DC 20005
(303) 672-2926

Its Attorneys

December 22, 2003

CERTIFICATE OF SERVICE

I, Richard Grozier, do hereby certify that I have caused the foregoing **REPLY COMMENTS OF QWEST** to be 1) filed with the FCC via its Electronic Comment Filing System, 2) served via e-mail on the FCC's duplicating contractor Qualex International, Inc., 3) served via e-mail on Ms. Janice Myles of the FCC's Wireline Competition Bureau, and, 4) served via First Class United States mail, postage prepaid on the parties listed on the attached service list.

/s/ Richard Grozier
Richard Grozier

December 22, 2003

Qualex International
Qualexint@aol.com

Janice M. Myles
Janice.myles@fcc.gov

John H. Harwood II……………………………………...Verizon
Lynn R. Charytan
Polly B. Smothergill
Wilmer, Cutler & Pickering
2445 M Street, N.W.
Washington, DC 20037-1420

Michael E. Glover
Edward Shakin
Joseph DiBella
Verizon
Suite 500
1515 North Courthouse Road
Arlington, VA 22201

David L. Lawson……………………………………...AT&T
Michael J. Hunseder
Sidley Austin Brown & Wood, LLP
1501 K street, N.W.
Washington, DC 20005

Leonard J. Cali
Lawrence J. Lafaro
Aryeh S. Friedman
AT&T Corp.
One AT&T Way
Bedminster, NJ 07921

Alan Buzacott
WorldCom, Inc. d/b/a MCI
1133 19th Street, N.W.
Washington, DC 20036

Anu Seam
Gary L. Phillips
Paul K. Mancini
SBC Communications Inc.
Suite 400
1401 Eye Street, N.W.
Washington, DC 20005

Stephen L. Earnest
BellSouth Corporation
Suite 4300
675 West Peachtree Street, N.E.
Atlanta, GA 30375-0001

Indra Sehdev Chalk
Michael T. McMenamin
Robin E. Tuttle
United States Telecom Association
Suite 600
1401 H Street, N.W.
Washington, DC 20005